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CORRESPONDENCE MEMORANDUM

DATE: November 30, 2004

TO: Wisconsin Deferred Compensation Board Investment Committee

FROM: Shelly Schueller, Director
Wisconsin Deferred Compensation Program

SUBJECT: Lifecycle Fund Series Selection

Throughout 2004, the Wisconsin Deferred Compensation (WDC) Board has been discussing the merits of lifecycle funds. At the November 9, 2004, meeting, the Board approved adding a series of lifecycle funds to the WDC Investment Spectrum. This memo provides background for that decision and serves as a cover memo for the lifecycle fund analysis provided by Nationwide Retirement Solutions (NRS) in the attached documents.

Background
As used by mutual fund firms, the term “lifecycle” describes the process of developing a diversified investment portfolio by strategically combining different asset classes in varying proportions according to an individual participant’s age or time horizon. Lifecycle funds are increasingly popular and appeal most often to participants who do not have the time, knowledge or interest to regularly monitor and adjust their investment portfolio allocations. These participants struggle to make the right investment choice, worry about the choices they make, and often forget to rethink and rebalance their investments on a periodic basis.

Lifecycle funds offer benefits for sponsoring plans as well as participants. Lifecycle funds:

- Appear to be the easiest options for participants to understand and enroll in.
- Address plan sponsor or provider concerns regarding offering investment advice.
- Use modern portfolio theory regarding risk and return.
- Provide an asset mix developed by a mutual fund family (not the WDC or participant).
- Are kept on target with systematic rebalancing by the mutual fund family.
- Appeal to participants with low investment knowledge or compensation levels.

Lifecycle funds are offered by many of the major mutual fund providers, including Vanguard, Fidelity, T. Rowe Price, Schwab, Barclays Global Investors, and Dimensional Fund Advisors.

Adding lifecycle funds could provide a benefit to certain segments of the WDC participant population. Lifecycle funds require the least engagement and fewest decisions by participants and less investment knowledge and education. Results from the 2004 WDC participant survey show that a majority of respondents (nearly 70%) said they would be very or somewhat interested in this type of fund.

Reviewed and approved by Dave Stella, Deputy Secretary

Signature Date

Discussion Points

The Investment Committee should carefully examine the philosophical reasons for adding lifecycle funds to the WDC before making any specific fund recommendations. Questions that should be discussed at the meeting include:

- What advantages will offering lifecycle funds provide for WDC participants?
- Which WDC participants may benefit the most from the addition of lifecycle funds?
- What are the important features of a lifecycle fund for WDC participants? Is the committee interested in funds that offer a larger spectrum of years, for example, or a higher equity exposure?
- The level of risk or aggressiveness that each lifecycle fund family provides, and whether or not the committee wishes to take into account a participant's WRS benefit when considering what lifecycle funds to recommend for inclusion in the WDC?

Once the reasons for adding lifecycle funds have been fully reviewed, the Investment Committee can move to considering specific lifecycle funds for inclusion in the WDC. As the attached memo from Curt Morrow at Nationwide Retirement Solutions (NRS) indicates, criteria used by the Investment Committee to evaluate lifecycle funds should include:

1. Quality of the underlying investment funds used in the portfolios
2. Number of funds offered (generally every five or ten years)
3. Fund expenses
4. Name recognition
5. Asset allocation strategy/equity exposure during accumulation
6. Asset allocation strategy/equity exposure during distribution
7. Desire for active or passive investment strategy, or a mixture of both
8. Performance relative to appropriate custom benchmarks that match each fund's investment allocation strategy. Note: as mentioned in the attached memo, direct performance comparisons for lifecycle funds can be difficult because each fund series is set up in a unique manner and investment strategies may not be similar. An effective approach to benchmarking lifecycle funds may be for the WDC to select the investment approach or asset allocation strategy that makes the most sense and then design custom benchmarks that measure the fund manager's success in achieving those objectives, and not look to benchmark the lifecycle funds to other funds.

Summary of Lifecycle Funds

After an initial assessment of the WDC's likely reasons for adding lifecycle funs and reviewing the universe of lifecycle funds, NRS recommends that the Investment Committee consider the following lifecycle fund series for addition to the WDC:

- *American Century My Retirement Portfolios (5 funds)*
- *Barclays Global Investments LifePath Portfolios (5 funds)*
- *Fidelity Freedom Funds (10 funds)*
- *T. Rowe Price Retirement Funds, Inc. (9 funds)*
- *Vanguard Target Retirement Funds (6 funds)*

With the exception of American Century, all of these companies are currently part of the WDC Spectrum of Investment Options and each offers a high quality approach lifecycle investing.

However, as the attached memo indicates, there are a few unique strategies used by each of these series which should be considered when evaluating the funds.

NOTE: The Investment Committee will need to decide whether or not they are comfortable with the T. Rowe Price lifecycle fund series. Underlying funds in this group include both the T. Rowe Price Mid-Cap Fund and the T. Rowe Price International Stock fund. The T. Rowe Price International Stock fund is being phased out of the WDC in 2005.

If the Committee is comfortable with the preliminary selection of potential lifecycle funds listed in this memo, staff will use the December 7, 2004 meeting results to gather more information and further refine the lifecycle fund selection process. Staff would plan to return to the Investment Committee in early 2005 with a short list of potential fund providers.

If the Committee is not comfortable with the current list of lifecycle funds, staff will work with NRS to enlarge the lifecycle fund search and return to the Investment Committee in 2005 with an expanded list that may meet the needs of the WDC.

Once the Investment Committee is satisfied with the analysis and has made a decision regarding potential lifecycle funds, staff will seek to schedule presentations from the lifecycle fund provider finalists for the Investment Committee sometime later in 2005.

Additional Steps

As noted in previous memos on this topic, the Board will need to make the following changes when lifecycle funds are added to the WDC:

1. Amend the WDC Investment Policy statement to add lifecycle funds as an investment category within the core spectrum.

2. Revise WDC investment option selection and monitoring criteria to provide for either a waiver, such as is currently done for the socially responsible investment option, or the development of a customized benchmark (such as a benchmark established by the proportional allocations of the benchmarks of the underlying asset classes, if possible).

Staff continues to work on these revisions for presentation to the Board. The Board would be asked to approve these changes at the same meeting at which specific lifecycle fund series recommendations are presented.